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Monthly Letter on
Economic Conditions Government Finance

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General Business Conditions

THE settlement of the coal strike has removed the chief obstacle in the way of Spring business, and in general the outlook for the next few months is now very satisfactory. In many respects the first quarter has been an active and promising period. While industrial production indexes were held down by the coal stoppage, the Chrysler strike, steel mill curtailment and the effects of coal and steel shortages on other industries, both consumer and business buying has held at high levels. In the aggregate manufacturers have added to their backlogs of unfilled orders. Many of the heavy industries particularly, including machine tools, are in a better position than they were at the beginning of the year. This is also true of some though not all non-durables. Paper, copper, zinc and other materials and products widely used through the industries, which are therefore useful measures of general conditions, are in strong demand.

Department and apparel stores report a disappointing Easter trade in soft goods. Some curtailment has appeared in primary textile production, especially rayon. However, any inference that overall consumer buying is lagging or purchasing power diminishing would be incorrect. The total of personal incomes, augmented by the veterans' insurance refunds, has reached a new high (using the seasonally adjusted annual rate reported by the Department of Commerce). Total retail sales in both January and February were 3 per cent above a year ago; declines in soft goods were more than offset by increased sales of automobiles and home furnishings. Retail sales of automobiles have broken all records, despite Chrysler's inability to supply its dealers. Much was made earlier of reports of sales of new cars at discounts, but the markets have tightened as the season has advanced and used car prices have stiffened.

All kinds of business related to housing, including building materials, household appliances, carpets and furniture, have had heavy sales and are under pressure to meet demand. The volume of construction activity and contract awards has exceeded anything ever before known at this season of the year. In January and February some 80,000 housing units were started each month, compared with 50,000 in the same months of 1949, and March seems certain to show a still higher figure. Daily average building contract awards in the first three weeks of the month reached a new alltime peak, according to the Dodge reports, with residential contracts 117 per cent above last year and all others up 26 per cent. Orders for lumber so far this year are ahead of last year by 21 per cent.

Spring Gains in Prospect

Thus the arrival of Spring finds most industries well-fortified with orders, with exceptional support from construction and automobiles, and with coal and steel producers under the necessity of catching up with demand and replenishing stocks. The end of the coal strike has been followed by a sharp rebound in bituminous output to above 13,000,000 tons weekly and in steel

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mill operations to around 97 per cent of capacity. These industries will hold their high rates for some time. The strength of automobile demand and the possibility of labor troubles will combine to keep automobile output high, and when the Chrysler strike ends the figures are almost certain to break all past records.

The Federal Reserve Board's index of industrial production, which was 180 in February (1935-39=100) recovered in March to 183 or higher. Further gains in April and May, to the best levels since January or February, 1949, are indicated. Warmer weather will bring the usual opening up of farm and road work and other outdoor activity. Employment should improve and consumer buying power continue large.

Inventory Policies Cautious

What the state of trade will be, and whether the markets will be cleared of all the production in prospect, are questions to which answers necessarily are less certain. As a usual thing upswings are accompanied by accumulation of goods, which eventually leads to a slackening of business buying and turns the trend the other way. Probably as time goes on other industries will find, as the rayon weavers have recently found, that stocks are building up between the primary producer and the consumer.

On the other hand, complaints are heard from manufacturers that mercantile buyers especially are carrying less than their share of the inventories necessary to support trade, and that they are unreasonable in their demands for "shipment the day before yesterday." This does not look like overstocking. Reports from purchasing agents do not suggest that they are lengthening their coverage appreciably, nor does the course of industrial prices indicate any considerable speculation, for despite rising wage rates and fringe costs such as pensions, the wholesale price index of non-farm products has hardly varied since last Summer.

Probably if a large group of purchasing agents were questioned they would say that the situation in industrial materials and supplies is generally such that speculative coverage is not required. In many commodities the relations of supply and demand have changed a good deal since the boom days of 1948. Productive capacity has been increased by expansion and modernization. More labor is available. Of course the situation varies from market to market, but bottlenecks are the rarity rather than the rule and generally prove temporary when they appear. In short, there is in the aggregate a greater cushion of actual or potential output to absorb demands without generating another sharp price rise. The change makes for more conservatism and stability in buying.

The Longer View

For the longer view a poll of business sentiment would probably reveal more uncertainty than extravagant optimism. All know that the catching up period in coal and steel will run its course, and that eventually the deferred demand for automobiles and housing, on which 1950 business rests so importantly, will weaken as it has in other lines. The cycle of fluctuations in soft goods is typically a short one, and an upturn which began eight months ago is not expected to hold its momentum throughout the year. The terms of settlement of the coal strike, which included increases in both wage rates and the welfare fund, encourage labor leaders in other industries to raise their demands, and hold the threat of other strikes or further burdensome increases in costs, or both.

In other areas, too, business men expect some weakening of the expansive forces. The Department of Commerce-S.E.C. survey of prospective expenditures on new plant and equipment in 1950, made public March 30, indicates a decline in the first half of the year of 6 per cent and in the second half of 14 per cent below the corresponding periods of 1949. For the year a total of $16.1 billion is forecast, compared with $18.1 billion last year and $19.2 billion in the peak year 1948. The 1950 figure is still very high, but it confirms earlier estimates of a progressive decline. Expectations that the volume of exports and the export surplus would fall off this year are also confirmed, at least temporarily, by the January trade figures. They showed an excess of exports over imports of only $120 million, which not only is sharply below the 1949 monthly average of $450 million, but is much less in amount than the dollars we are giving away each month. A caution should be interjected against reading too much into one month's figure.

Finally, people are beginning to wonder whether the addition to purchasing power that is represented by the expansion of instalment loans may not begin to top off before the year is out. Consumer credit of all kinds has increased an average of $3 billions a year during the postwar period. When the end of the rise comes the forces making for business expansion will be reduced by an equivalent amount, other things being equal. The $2.8 billions of the veterans' insurance refund is of course a one-time stimulus.

These are all reasons why business looks further ahead with conservatism.

The Unemployment Figures

The estimate of unemployment in February, reported by the Bureau of the Census, has attracted much attention because the figure of 4,684,000 is the highest since the Fall of 1941. Perhaps it has received more attention than it deserved, considering that the Spring months always bring a marked pickup in agricultural employment. This year a rise in industrial operations is also occurring. Hence April and May figures are likely to be considerably lower.

Nevertheless an issue is appearing with which, according to current reports, economic advisers to the Government are much concerned. The question is whether the economic organization will provide employment for all the new workers who enter the labor force each year. If the answer is negative, unemployment will rise by the amount of these additions, even though employment is fully maintained. Between February 1949 and February 1950 the Census Bureau calculates the addition to the civilian labor force at 1,249,000.

Current accounts say the government economists are working on "plans" to take care of such an increase in unemployment, if it comes. Proposals mentioned include of course new government spending projects, designed to provide work through the construction or other industries, also programs to absorb young people reaching working age into some counterpart of the depression-born Civilian Conservation Corps camps.

The responsibility for employment is a long-debated and fundamental question. If the debate is to be resumed again, it is altogether deplorable that the first thoughts of the government economists should turn to "make-work" projects and new and greater government spending programs, which would add to taxes or to the public deficit and would produce no equivalent value of product for the work done. The question to which they can most profitably address themselves is not how unemployment is to be relieved, but how employment is to be created. The way to make more employment, Mr. John M. Hancock of the Baruch-Hancock team once said, is to make more employers. Employers are made by preserving incentives to produce and to expand productive enterprise. In the free system the principal incentive, and the most effective one, is the hope of profit. Moreover, it is through profits, together with individual savings and investment, that the economic organization is provided with the tools and equipment which make employment possible.

The first great barrier to the expansion of employment in proportion to the increase in the labor force is to be found in the tax system, which rewards effort on a diminishing scale, graduated down almost to the vanishing point; which discourages risk and venture; and which because of the sheer burden of taxes reduces the saving and impedes the investment which the economic organization must have if it is to grow.

The second major impediment is the encroachment of costs on profit and the consequent weakening of the profit expectation. In much discussion of this subject the importance of the terms of employment, namely the wage rate and other conditions affecting costs, receives nothing like the notice to which it is entitled. It should be obvious that except under inflationary conditions, where demand continues at higher prices, the effect of rising wage and other costs is to reduce employment because of the cases in which higher labor costs make the use of labor unprofitable.

At present labor demands, and the increase in costs which they would bring about, are centered heavily on pensions. It would be interesting to know how many labor leaders have ever asked themselves whether in forcing up industrial costs to care for pensioned workers they may be reducing the opportunity for employment of the younger people coming into the labor force. Yet that may be the result, if the encroachment of costs on earnings causes curtailment of industrial expansion.

Corporate Earnings in 1949

Annual reports for 1949 now issued by some 3,300 corporations, representing a large majority of all which publish their financial statements and almost half of the total assets of all American corporations, make a somewhat less favorable showing than the preliminary summary given in our Letter last month. The combined net income of all reporting companies in 1949, after taxes and after deducting deficits, amounted to $10.4 billion, compared with $11.8 billion in 1948, a decrease of 12 per cent, but still a good showing compared with earlier years.

Three out of five, on the average, of all reporting companies showed smaller earnings in 1949 than in 1948, and with some outstanding exceptions the trend was generally downward whether measured by dollar net income, profit margin on sales, or rate of return on net assets. A condensed summary is given on the next page, while a detailed summary by 70 major industrial groups appears on the following page.

Net Income of Leading Corporations for the Years 1948 and 1949
(In Millions of Dollars)

No. of Cos.		Net Income After Taxes 1948	Net Income After Taxes 1949	Per Cent Change	% Margin on Sales 1948	% Margin on Sales 1949
1,710	Manufacturing	$ 8,172	$ 6,998	—14	7.5	6.8
109	Mining, quarrying	312	230	—26	14.5	12.8
187	Trade	708	577	—18	3.8	3.3
239	Transportation	748	492	—34	6.9	4.8
284	Public utilities	934	1,025	+10	11.4	11.9
111	Amusements, services	93	90	— 4	4.7	4.8
682	Finance	842	1,021	+21	—	—
3,322	Total	$11,805	$10,483	—12	7.3	6.6

Comparison of sales or operating revenues published for 1949 by about nine-tenths of all the reporting nonfinancial companies indicate an average profit margin of 6.6 cents per dollar, compared with 7.3 cents in 1948. While the total dollar volume of business receded only slightly from the record level of 1948, the high and relatively inflexible operating costs had the effect of shaving profit margins per sales dollar more closely. The public utility group, however, improved both its dollar net income and return on sales, accompanying a continued growth in operating revenues and plant capacity.

Manufacturers' Earnings Lower

Figures now available for 1,710 companies in the manufacturing industries, with net assets comprising over half the total for all reporting companies, show a decrease in net income of 14 per cent. Although our preliminary summary last month indicated a decrease of only 10 per cent, earnings totals were pulled down this month by the additional reports of more than 700 companies, including many of the large oil companies whose earnings were off substantially, as well as numerous companies showing net deficits. Of the manufacturing reports now summarized for 1949, 182 companies reported deficits totaling $83 million, against 104 with deficits totaling $71 million in 1948.

Some 70 per cent of all reporting manufacturing companies showed decreases in net income last year, against 30 per cent with increases. Of the 45 major groups given in the summary, 36 show decreases, against 9 with increases. Included in the groups managing to buck the general downward trend in earnings were dairy products, brewing, tobacco, chemicals, cement, glass, agricultural implements, automobiles, and aircraft, where increases reflected gains in sales or better control of expenses.

In view of the publicity attached to the large earnings of certain leading organizations in the automobile and steel industries, it may be well to call attention to the widely varying results achieved by different companies in those lines. Taking first a group of 25 automobile and truck manufacturers which had an overall increase of 39 per cent in net earnings last year on an 18 per cent increase in sales, it will be found that four large companies had increases in net income totaling 48 per cent on a sales increase of 24 per cent, while three other large companies had a drop in net income of 40 per cent on a sales decrease of 10 per cent. Combined figures for eighteen smaller companies, including truck manufacturers, showed a drop from net income to a net deficit, on a sales decrease of 30 per cent.

Similarly, in the steel industry, whose earnings have recently been the target of Congressional criticism, the experience has been by no means uniform. A group of 54 iron and steel manufacturers showed an overall decrease in net income last year of 5 per cent. Whereas 9 of these companies had actual increases, 13 had decreases running up to 25 per cent, 18 had decreases of 26 to 50 per cent, 12 had decreases of over 50 per cent, and 2 had deficits.

Profit Margins on Sales

For all manufacturing companies reporting sales in 1949, the average profit margin was 6.8 cents per sales dollar, compared with 7.5 cents in 1948. The 1949 margin was only slightly wider than the average of the last fifteen years, and narrower than in other years of high business activity such as 1936-37, 1940, and 1947.

The trend of earnings since 1935 may be seen from the accompanying table, based upon our annual summaries of published shareholders' reports. While the dollar figures are not strictly comparable because of the variation in number of reports available for the different tabulations, which ranged from 1,193 in 1935 to 1,710 in 1949, the annual average profit margins indicate the general pattern.

Net Earnings of Leading Manufacturing Corporations
(In Millions of Dollars)

Year	No. of Cos.	Net Income	Net Assets Jan. 1	% Return on Assets	Sales	% Margin on Sales
1935	1,193	$1,822	$19,820	6.7	$23,607	5.6
1936	1,279	2,007	19,251	10.4	26,408	7.6
1937	1,410	2,481	23,067	10.8	33,527	7.4
1938	1,410	1,139	23,876	4.8	28,475	4.0
1939	1,440	1,938	22,916	8.5	29,815	6.5
1940	1,495	2,628	25,598	10.3	35,040	7.5
1941	1,420	3,216	25,870	12.4	49,476	6.5
1942	1,336	2,522	24,906	10.1	58,651	4.3
1943	1,321	2,496	25,187	9.9	69,333	3.6
1944	1,327	2,890	29,557	9.8	87,576	3.3
1945	1,406	2,723	29,907	9.1	69,821	3.9
1946	1,511	4,091	33,674	12.1	68,183	6.0
1947	1,571	6,317	37,062	17.0	88,972	7.1
1948	1,680	8,063	42,607	18.9	107,507	7.5
1949	1,710	6,998	50,656	13.8	103,222	6.8

Source: National City Bank annual tabulations of published shareholders' reports, the number of which available for the different tabulations varied from 1,193 in 1935 to 1,710 in 1949. The sales total is partly estimated, on the basis of all companies reporting sales figures, which in 1949 represented about nine-tenths of the total number and of the total net income.

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1948 AND 1949

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1948	Reported Net Income After Taxes 1949	Per Cent Change†	Book Net Assets Jan. 1 -a 1948	Book Net Assets Jan. 1 -a 1949	% Return on Net Assets -a 1948	% Return on Net Assets -a 1949	% Margin on Sales -b 1948	% Margin on Sales -b 1949
22	Baking	$ 69,125	$ 63,629	— 8	$ 328,687	$ 357,758	21.0	17.8	5.2	5.2
18	Dairy products	64,110	80,528	+26	493,317	528,706	13.0	15.2	2.4	3.2
19	Meat packing	47,048	30,720	—35	787,136	805,360	6.0	3.8	0.7	0.5
23	Sugar	55,785	41,676	—25	482,068	500,308	11.6	8.3	6.0	4.4
82	Other food products	257,376	236,522	— 8	1,522,220	1,640,300	16.9	14.4	4.6	4.8
17	Soft drinks	48,310	45,651	— 6	269,194	289,875	17.9	15.7	11.2	10.4
30	Brewing	33,426	39,662	+19	181,504	210,950	18.4	18.8	8.0	8.2
12	Distilling	154,157	113,291	—27	620,495	736,960	24.8	15.4	7.2	5.5
23	Tobacco products	143,292	157,765	+10	1,010,178	1,094,876	14.2	14.4	5.2	5.5
40	Cotton goods	175,249	69,027	—61	580,436	695,348	30.2	9.9	12.2	5.8
14	Silk and rayon	111,344	57,894	—48	403,379	477,012	27.6	12.1	13.8	9.1
7	Woolen goods	31,420	8,739	—72	156,033	174,320	20.1	5.0	7.1	2.6
16	Hosiery, knitted goods	22,062	12,482	—43	95,460	113,029	23.1	11.0	9.2	5.1
49	Other textile products	179,031	96,539	—46	743,679	885,344	24.1	10.9	8.7	5.3
31	Clothing and apparel	31,852	19,342	—39	229,671	246,755	13.9	7.8	4.5	3.1
9	Leather tanning	7,389	2,152	—71	64,043	65,287	11.5	3.3	3.9	1.0
24	Shoes, leather products	37,158	27,987	—25	262,689	273,667	14.1	10.2	4.1	3.4
23	Tires, rubber products	120,763	87,533	—28	898,334	975,966	13.4	9.0	4.1	3.6
28	Lumber	101,584	58,783	—42	439,919	521,732	23.1	11.3	11.2	8.3
18	Furniture, wood products	25,339	18,311	—28	138,711	163,881	18.3	11.2	6.6	5.5
80	Pulp and paper products	285,066	202,085	—29	1,451,748	1,635,973	19.6	12.4	10.6	8.1
34	Printing and publishing	50,642	42,593	—16	353,658	385,225	14.3	11.1	6.2	5.5
65	Chemical products	494,083	535,844	+ 8	2,922,414	3,238,039	16.9	16.5	9.9	10.3
32	Drugs, soap, cosmetics	154,884	130,857	—16	727,613	809,813	21.3	16.2	7.1	7.1
19	Paint and varnish	46,530	39,914	—14	354,840	388,096	13.1	10.3	4.4	4.5
44	Petroleum products	1,930,078	1,420,689	—26	9,160,640	10,761,367	21.1	13.2	12.9	9.9
31	Cement	46,011	53,839	+17	270,191	297,519	17.0	18.1	14.0	15.8
13	Glass products	69,525	89,649	+29	448,568	485,072	15.5	18.5	7.8	9.9
45	Other stone, clay products	118,205	100,809	—15	648,298	733,343	18.2	13.7	10.0	9.5
54	Iron and steel	577,112	560,541	— 5	4,147,802	4,783,752	13.9	11.5	6.7	7.2
12	Agricultural implements	139,477	171,988	+23	1,025,249	1,105,630	13.6	15.6	6.2	7.6
75	Building, heat., plumb. equip.	142,786	101,047	—29	710,092	796,698	20.1	12.7	7.9	6.3
80	Electrical equip., radio & tv.	349,873	338,466	— 3	1,727,345	1,973,440	20.3	17.2	6.0	6.1
47	Hardware and tools	54,750	35,726	—35	335,916	366,423	16.3	9.7	8.0	5.8
45	Household appliances	86,274	52,721	—39	324,360	378,573	26.6	13.9	7.6	5.3
166	Machinery	246,909	190,764	—23	1,327,108	1,502,808	18.6	12.7	8.0	7.0
27	Office equipment	108,402	95,295	—12	445,428	513,942	24.3	18.5	10.5	9.6
34	Nonferrous metals	352,971	205,973	—42	2,304,300	2,499,494	15.3	8.2	11.7	8.2
94	Other metal products	186,655	130,753	—30	1,090,742	1,196,814	17.1	10.9	6.8	5.0
25	Autos and trucks	617,714	857,065	+39	2,430,993	2,781,625	25.4	30.8	7.4	8.9
68	Automobile parts	188,048	175,938	— 6	820,122	941,705	22.9	18.7	7.1	6.3
27	Railway equipment	78,905	60,171	—19	805,218	837,340	9.2	7.2	5.4	4.4
27	Aircraft and parts	17,727	50,878	+....	601,773	592,323	2.9	8.6	1.4	3.3
4	Shipbuilding	7,849	6,215	—21	64,661	69,291	12.1	9.0	5.1	5.0
57	Misc. manufacturing	111,084	90,403	—19	753,592	824,360	14.7	11.0	8.9	7.6
1,710	Total manufacturing	8,172,380	6,998,456	—14	44,959,824	50,656,049	18.2	13.8	7.5	6.8
30	Coal mining -c	99,225	52,001	—48	614,780	676,813	16.1	7.7	7.9	5.2
27	Metal mining -c	43,676	34,053	—22	383,205	408,895	11.4	8.3	11.6	9.2
40	Oil and gas -c	134,699	107,888	—20	387,278	496,154	34.8	21.7	33.1	26.9
12	Other mining, quarrying -c	34,413	35,867	+ 4	138,415	122,906	24.9	29.2	26.6	26.9
109	Total mining, quarrying	312,013	229,809	—26	1,523,678	1,704,768	20.5	13.5	14.5	12.3
19	Chain stores—food	50,083	58,688	+17	292,810	328,853	17.1	17.8	1.3	1.6
57	Chain stores—variety, etc.	168,675	135,963	—19	1,014,372	1,098,798	16.6	12.4	5.1	4.3
49	Department & specialty	186,961	162,541	—13	1,105,922	1,230,256	16.9	13.2	3.5	3.5
6	Mail order	211,877	155,640	—27	907,681	1,072,397	23.3	14.5	5.4	4.6
56	Wholesale & miscellaneous	90,127	64,255	—29	559,442	627,919	16.1	10.2	3.3	2.5
187	Total trade	707,723	577,037	—18	3,880,227	4,358,223	18.2	13.2	3.8	3.3
132	Class 1 railroads -d	698,057	436,000	—38	13,094,224	13,725,192	5.3	3.2	7.4	5.1
32	Traction and bus	5,850	5,581	— 5	424,580	384,094	1.4	1.5	4.2	1.2
10	Shipping	16,216	11,889	—27	237,980	243,780	6.8	4.9	3.1	3.3
15	Air transport	— 181	17,279	+....	256,753	261,346	— 0.1	6.6	— 0.3	3.3
50	Misc. transportation	23,517	21,241	—10	240,922	252,902	9.8	8.4	8.1	6.6
239	Total transportation	743,459	491,990	—34	14,254,459	14,867,314	5.2	3.3	6.9	4.8
219	Electrical power, gas, etc. -d	687,546	768,347	+12	7,527,910	8,021,346	9.1	9.6	13.5	14.4
65	Telephone & telegraph -d	246,510	256,481	+ 4	3,364,303	3,735,781	7.3	6.9	8.2	7.8
284	Total public utilities	934,056	1,024,828	+10	10,892,213	11,757,127	8.6	8.7	11.4	11.9
16	Amusements	29,173	29,581	+ 1	480,218	482,044	6.1	6.1	3.9	4.4
46	Restaurant and hotel	13,875	11,470	—17	133,663	135,031	10.4	8.5	4.6	3.9
29	Other business services	31,334	30,705	— 2	195,452	214,987	16.0	14.3	7.1	7.1
20	Construction	18,590	17,957	— 3	110,257	121,760	16.9	14.7	3.7	3.7
111	Total amusements, services, etc.	92,972	89,713	— 4	919,590	953,822	10.1	9.4	4.7	4.8
294	Commercial banks -e	435,480	466,274	+ 7	5,560,427	5,791,752	7.8	8.1	....	....
67	Fire and casualty insurance -e	130,221	204,121	+57	1,430,250	1,532,445	9.1	13.3	....	....
151	Investment companies -e	177,125	230,896	+30	2,633,705	2,743,846	6.7	8.4	....	....
61	Sales finance companies	85,037	105,858	+24	587,903	678,996	14.5	15.6	....	....
109	Real estate companies	14,219	13,543	— 5	146,600	151,086	9.7	9.0	....	....
682	Total finance	842,082	1,020,692	+21	10,358,885	10,898,125	8.1	9.4	....	....
3,322	Grand total	$11,804,685	$10,432,525	—12	$86,788,876	$95,195,428	13.6	11.0	7.3	6.6

a—Net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent about nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures represent in some cases operating earnings only, excluding gains or losses on investments. †Increases or decreases of over 100% not computed. — Deficit.

It will be seen that the large increase in dollar net income in the manufacturing industries during this period has come primarily from the great expansion that has taken place in the dollar volume of sales, largely as a result of the inflation of commodity prices and costs, rather than from any appreciable widening of profit margins.

Rising costs in recent years have been covered partly by an increase in selling prices, and partly by the spread of overhead expenses over a much greater volume of business. Dependence upon such high volume, however, makes the net earnings vulnerable to a sharp squeeze in the event of a moderate increase in costs, a falling off in sales, or a reduction in selling prices, as many lines experienced last year after they had satisfied the accumulated demands for their products and returned to normal competitive conditions.

The sharp rise in rate of return on net assets from 1945 to 1948 – before turning downward in 1949 – was due in part to the lag in the growth of book values at which such assets are carried on the balance sheets. A large portion of the fixed assets of manufacturing corporations represents plant and equipment valued at original costs, less depreciation, which have been and still are far below prevailing replacement costs. For this reason, the rates of return computed on book values overstate the return on present-day values, and will continue to do so for years to come. It will be a long time before the book assets reflect fully the high costs of the vast investment of new capital needed since the war for the modernization and expansion of industrial facilities.

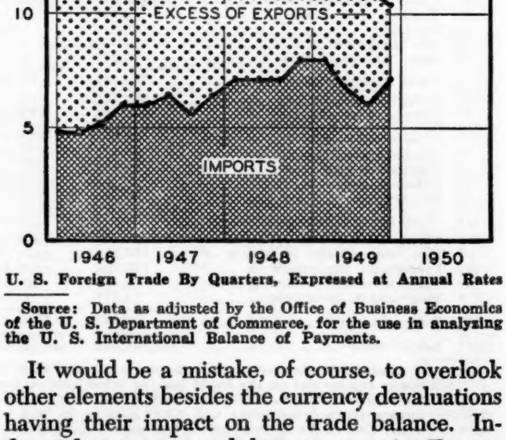
Currency Devaluations — Six Months After

Enough time has now passed since the widespread currency revaluations of last September to see some concrete results. Since then American exporters have faced more effective price competition abroad and have had to give up some ground to foreign producers. Foreign goods, offered in larger quantities and more attractively priced, have had a good reception in American markets. Our excess of exports over imports has narrowed, so much indeed as to alter the proportions of the "dollar gap" foreseen last fall for 1950. The $5 billion a year rate at which dollars have been supplied to the world by U. S. Government foreign aid and loan programs is more than enough to cover the gap, and foreign currency reserves have increased.

In the case of the United Kingdom and associated sterling area countries, the recovery in reserves has been accomplished in considerable measure by reduced quotas on dollar imports. Some other countries, with improved reserves, are allowing a freer access on the part of their citizens to American goods. Colombia, Brazil and Argentina, among other Latin-American countries, have taken the occasion to pay down at least part of their accumulations of trade debt.

Narrowing Export Surplus

Progress in the narrowing of the American export surplus is brought out in the accompanying chart showing the movement of U. S. exports and imports by quarters since 1946, the figures being expressed at annual rates. The export surplus at its peak, in the summer of 1947, was at a rate of almost $11 billion with exports running at an unprecedented level of $17 billion a year. During 1948 our exports declined, and imports rose, narrowing the export surplus to $5 billion a year. This rate, achieved in the third quarter, seemed incompressible until the devaluations had been accomplished, a year later. In the final quarter of 1949 the export surplus was pinched off from both sides – lower exports and larger imports – and reduced to a rate of $3½ billion a year. In January, not shown on the chart, exports declined further. With a sustained volume of imports the gap narrowed still more.



U. S. Foreign Trade By Quarters, Expressed at Annual Rates

Source: Data as adjusted by the Office of Business Economics of the U. S. Department of Commerce, for the use in analyzing the U. S. International Balance of Payments.

It would be a mistake, of course, to overlook other elements besides the currency devaluations having their impact on the trade balance. Industrial recovery and better crops in Europe

had contributed heavily to the narrowing of the trade gap in 1948. The business dip here, with price declines, cut down our imports of industrial raw materials in the spring and summer of 1949 and fears of devaluation had a retarding effect on imports in the third quarter. Efforts of foreign countries to check monetary and credit inflation have become effective in various countries at various times. Direct restrictions on imports from the dollar area, imposed to protect currency reserves, have been in force throughout the postwar years. While Canada and some other countries are loosening up on import restrictions, the 25 per cent cut in dollar area purchases, imposed by Great Britain and associated sterling area countries last summer, is still in effect. In the last quarter of 1949, one of our best customers, the Philippines, imposed new and drastic import and exchange regulations in an effort to bring their international payments into better balance.

Four Months' Figures

As indicated in the following table, which covers the four months, October, 1949 through January, 1950, our trade surplus in the post-devaluation period is practically limited to the areas benefitting from various U. S. Government grant and loan programs (European Recovery Program, Army relief, special payments to the Philippines, etc.). The countries outside of these areas have generally balanced their trade with us, or are earning more dollars than they are spending here. This is especially true of our transactions with Latin America, which, as a whole, is earning a small dollar surplus in direct trade with the United States for the first time since the end of the war. Latin-America, and Canada as well, are also indirect beneficiaries of dollars channelled under government programs to Europe and the Far East.

United States Foreign Trade by Major Areas
(In Millions of Dollars)

	Four Post-Devaluation Months (Oct. 1949 through Jan. 1950)			Correspond. Period of Previous Yr. (Oct. 1948 through Jan. 1949)		
	Exports	Imports	Balance	Exports	Imports	Balance
United Kingdom	182	81	+101	210	101	+ 109
Other ERP Europe*	937	227	+710	1,166	257	+ 909
Far East†	313	127	+186	342	142	+ 200
Total	1,432	435	+997	1,718	500	+1,218
Canada	567	560	+ 7	658	583	+ 75
Latin America	809	835	— 26	1,058	781	+ 277
Sterling Area (except U.K.)	289	318	— 29	460	333	+ 127
All other countries	276	233	+ 43	316	261	+ 55
Total	1,941	1,946	— 5	2,492	1,958	+ 534
Grand Total	3,373	2,381	+992	4,210	2,458	+1,752

*Including Turkey. †Japan, Korea, China, Formosa, Manchuria, and the Philippines.

Total U. S. exports in the October through January period — at a rate of roughly $10 billion per annum — were 20 per cent lower than in the corresponding period a year earlier. Imports — at $7 billion a year — were within 5 per cent of the year-earlier level which was about the peak of the postwar period.

Most commodity categories shared in the export decline, though the greatest drop continued to be shown by those groups which had experienced the greatest expansion over prewar. Cotton and tobacco exports increased, but exports of foodstuffs were substantially lower. Coal, petroleum, steel, textiles, automobiles and machinery exports all showed declines. With Europe's production running 20 to 25 per cent higher than before the war, with Japan's comeback, and with currency readjustments restoring the capacity of foreign producers to export at competitive prices, the froth is definitely off the postwar export boom. A question which only time can answer is whether the $10 billion current level — a very high one by any prewar standard — can be maintained.

On imports, the figures were running ahead of a year ago for coffee and wool, where higher prices rule, and also for tin, hides and skins, and pulp. Rubber, cocoa, copper, and zinc imports were larger in physical volume but smaller in dollar value because of lower prices. Our position as net importers of petroleum products seems now to be established, a result of discriminations against "dollar oil" abroad and the expansion of refinery facilities as well as of crude production abroad.

Recovery in Currency Reserves

That the decided narrowing of the export trade balance in the final quarter of 1949 was no "flash-in-the-pan" development is confirmed by the trade figures for January, cited earlier, and indirectly by a continuing recovery in overseas reserves of gold and dollars in the first quarter of 1950. According to an estimate published in the March Federal Reserve Bulletin, the recovery in gold reserves overseas amounted to $289 million in the last quarter of 1949. From the movement of the U.S. gold stock, and with an allowance for new gold production, another increase of around the same magnitude is indicated for foreign gold reserves in the first quarter of 1950.

Significantly, the gold acquired by foreign governments and central banks from the U.S. gold stock has not been, overall, at the expense of the dollar balances they carry here. Foreign deposits with the Federal Reserve Banks, indeed, are now $350 million higher than they were at the time

of the September currency devaluations. And indications are that foreign holdings of short-term dollar investments, forming part of their currency reserves, have also been increased. The aggregate recovery in foreign gold and dollar reserves, in the six months following the devaluations, runs to a billion dollars.

How this billion has been spread out by countries cannot be determined at this early date. Finance Minister Abbott has revealed that Canadian gold and dollar reserves on March 25 amounted to $1¼ billion, an improvement of $250 million since September. Among countries known to have acquired substantial amounts of gold since September are the United Kingdom, the Netherlands, Venezuela, Argentina, Thailand, and Egypt. Switzerland, Belgium, Italy, and Cuba held noteworthy gains in their reserves that they had accomplished earlier in 1949 and in 1948. The Philippines, which did not devalue, on the other hand faced an accelerated drain on their reserves during the final quarter of 1949 until import and exchange controls were imposed. Some members of the sterling group presumably have contributed to the United Kingdom's recovery in reserves, while other countries loosely linked to sterling – such as Sweden and Egypt – have directly acquired gold or dollars as backing for their currencies.

Is Foreign Aid Excessive?

The turnabout in currency reserves following devaluation could not have been accomplished without the supplies of dollars made available by the United States Government – at a recent rate of $5 billion a year – under E.R.P. and other grant and loan programs. But the conclusion is a natural one that U.S. aid can now safely be reduced. The weight of the aid program on our unbalanced budget calls for the earliest possible lifting of the load. Certainly the deficit is a bad example to foreign countries struggling with topheavy government establishments.

The most cogent reason for reduction is that the foreign aid was specifically designed to be scaled down. The European Recovery Program is now about to enter the third year of its scheduled four-year term. The outlays in the first full year, which ended June 30, 1949, ran to $4 billion. During the current second year of the program – with the benefit of an appropriation cut last summer – the expenditure rate has been decelerated to a $3 billion annual rate in the first three months of 1950. The question is now before Congress how much the program can safely be reduced in the third year. Two considerations doubtless will weigh heavily in the deliberations: the dangerous situation of the budget as a whole; and, on the other hand, the damage that might be done to the E.R.P., and to the prospects for loosened trade barriers, from too precipitate cutting.

In the broad view, the diminishing of the abnormal export surplus, and the recovery in foreign currency reserves likewise, represent constructive developments, and give tangible ground for long-expressed hopes of a better balanced trade among the nations and a restoration of confidence in currencies. Strengthened reserves are necessary for currency stabilization and a loosening of trade and money barriers. Thus far lessened exports from the United States and some increase in imports have been absorbed by our economy without serious damage. The total result is heavily on the plus side.

The Budget Outlook

The action by the House Appropriations Committee last month in approving an omnibus bill cutting nearly $1,400 million from appropriations requested in the President's budget for the fiscal year ending June 30, 1951, sets the stage for another battle in Congress to determine whether our Government can control its spending and live within its income, or whether it is going to drift further along the path of unbalanced budgets and mounting national debt.

The omnibus bill, now before the full House, marks something new in Congressional money-voting procedure. Instead of having the appropriations for the various government departments and agencies presented in perhaps twenty separate bills as in the past, the new system involves, in effect, wrapping up the separate supply measures in a single package, to be considered and acted upon more or less at the same time.

In this case, the bill includes funds for seventeen major functions, aggregating nearly 60 per cent of the total budget. Items not included are principally the foreign aid program, to be taken up separately, and interest on the public debt, covered by a permanent appropriation. In the following table we give the committee's recommendations for appropriations for fiscal 1951, compared with those asked for by the President in January.

It will be seen that appropriations recommended total $27,266 million, against the budget request of $28,652 million, a decrease of $1,385 million. Actual expenditures for the same items are estimated at $23,424 million, against a budget figure of $24,403 million, a cut of $979 million.

Government Appropriations for Fiscal Year 1951. Comparison of Recommendations by House Appropriations Committee with January Budget Estimate

(In Millions of Dollars)

	January Budget	Committee Recommendations	Change
Legislative branch (excl. Senate)	$ 65	$ 57	— 8
The Judiciary	24	24	— 1
Executive Office of the President	10	10	— 1
Independent Offices	8,149	7,629	— 520
Federal Security Agency	1,635	1,592	— 43
General Services Administration	862	836	— 26
Housing and Home Finance Agency	47	23	— 24
Department of Agriculture	806	764	— 42
Loan authorizations*	610	520	— 90
Department of Commerce	782	725	— 57
Dept. of Defense—military	13,025	12,822	— 203
" " " —civil	835	633	— 202
Department of Interior	669	622	— 48
Department of Justice	147	144	— 3
Department of Labor	220	209	— 11
Post Office Dept. (gen. fund)	555	401	— 153
Department of State	230	218	— 12
Treasury Department	577	546	— 31
District of Columbia	12	12	——
Bill total	28,652	27,266	—1,385
Items not considered in this bill	11,593	11,593	——
Budget total	$40,245	$38,859	—1,385

*Included in previous item total.

In addition, the committee trimmed $182 million from the President's request of $1,961 million for contract authorizations in fiscal '51 for which funds would have to be appropriated in later years.

Proposed Budget Cuts Inadequate

The proposed cut of $979 million in expenditures – to the extent it is real – represents a step in the right direction. But it is a very timid and inadequate step when viewed in the light of the size of the impending federal deficit and the uncertain character of some of the expenditure reductions listed.

Even if outlays are cut $979 million, as contemplated in the bill, the budget would still show a deficit for fiscal '51 of $4,154 million, which is too much. In fact, with the high level of incomes and business activity the country is enjoying, there should be no budget deficit at all.

It should be noted, also, that the foregoing calculation of deficit is based on estimated revenues of $37,306 million as carried in the January budget. This may prove to be optimistic. Some time this month we can expect to have new revenue estimates for next year by the tax experts of the Congressional Joint Committee on Internal Revenue Taxation. For the current fiscal year to March 28, actual receipts have run 5 per cent under those of the corresponding period a year ago, whereas the budget estimate assumed a decrease of only 2 per cent for the year as a whole.

Moreover, analysis of the spending cuts indicates that, while some appear to effect real savings, others are doubtful. A slash of $193 million in veterans' pension and readjustment benefits, for example, was based on a committee guess that actual claims would fall that much below the Veterans Administration estimate. Since pensions and benefits are fixed by law, unless the committee's guess proves to be better than that of the V.A. this money will simply have to be provided later.

There are other "savings" in much the same category. Some Congressional analysts of the budget believe they may amount to as much as $400 million out of the $979 million ostensible savings reported in the bill. Considering that the President's budget estimates included the assumption that the Treasury would pick up some $400 million in postal rate increases that are unlikely to be granted, the prospect of substantial real saving does not appear to be very bright.

There is, to be sure, still a chance for economy through Congressional action in instituting further budget cuts and in turning back new legislation for increased spending, as in the case of the Administration's proposal to set up a government corporation for financing, with government-guaranteed obligations, up to $2 billion of long-term low interest loans to housing construction cooperatives for middle-income families. House advocates of economy assert they hope to slice another $1 to $2 billion out of the omnibus bill before they are through with it. The House has tentatively approved a $2,850 million authorization for the European Recovery Program in the 1951 fiscal year, a reduction of $250 million from the amount proposed in the executive budget. On the other hand, more money may be voted for national defense.

It may be remembered that there was a great deal of talk about cutting the budget a year ago. What actually happened was the reverse. Congress ended up by spending more, not less, than the budget called for. This was due both to the Administration practice of following up the initial budget with supplementary requests for additional spending, and to Congress kicking over the traces and voting "on its own" sums over and above those recommended by the President.

This tendency for Congress to kick over the traces has again been evident this year in such actions as voting a special $163 million pay increase for veterans in the postal service, in the face of opposition by the Post Office Department, the Budget Bureau, the Civil Service Commission, and the Comptroller General.

Further Budget Cuts Possible

There is not the slightest doubt that further budget-cutting is possible, if only there is the

will to do it. Evidence on this score from testimony before Congressional committees, from the Hoover Commission, and from other sources, is conclusive. It is apparent also in the recent House Appropriations Committee report itself.

"The committee is of the opinion," the report declared, "that most agencies of Government are greatly overstaffed." Noting that "the functions of many sections and bureaus overlap and some functions are unnecessary," the report told the Budget Bureau to investigate. Such a survey, it said, should save "millions of dollars."

The committee cut off, for the present calendar year, the practice by government employees of accumulating their 26-day annual leave up to 60 days, and recommended that Congress take steps to prevent abuse of the leave privilege in the future. It said that the executive branch should abandon the custom of seeking contract authorizations, and instead ask direct appropriations to avoid "committing the federal budget to substantial expenditures for several years ahead."

Criticism of individual offices ranged from charging the Army Corps of Engineers in its rivers-and-harbors projects with conduct "bordering on profligacy" in "continuing to commit the Government to the expenditure of funds far in excess of amounts contemplated by the Congress either at the time of the original authorization of the projects or at the time funds were appropriated for initiation of construction," down to the Bureau of Standards for spending $1,000 an acre to maintain its lawns and landscapes "whereas costs of over $100 per acre are considered excessive."

Discussing efficiency in the Post Office Department, the report voiced the belief that "sizable savings" could be made by using more machinery in many operations, and by reducing the number of mail deliveries per day in certain residential areas. In the Department of Agriculture, the committee found "overlapping and duplication of activities", particularly in connection with those in the field "where a large number of separate organizational units are conducting separate and in many cases completely independent programs, each with a separate representative contacting the farmer."

Some Major Loopholes

Some of the biggest loopholes through which federal money is being poured out lie in the fields of veterans, agriculture, housing, and public power development.

The President himself has repeatedly called attention to abuse of veterans benefits, yet Congress has responded by voting more benefits. He has recommended that Congress cut back veterans unneeded hospital construction, and been refused.

The flagrant lack of coordination of facilities in the Army, Navy, and veterans hospital programs is an old story, told at length in the Hoover report, and brought out again in hearings last month before the House Armed Services Committee where the following examples were cited:

A budget request is pending for a new $18,000,000 veterans hospital in the Los Angeles area, while the Navy is closing the 1,500-bed Long Branch Naval Hospital in the same area.

A 500-bed veterans hospital is being built in Philadelphia, while the Army is closing the 2,000-bed Valley Forge Hospital twenty miles away.

The veterans agency plans to build 1,000 bed hospitals in Boston and at Brockton, Mass., while the Army is closing Murphy General Hospital at Waltham, Mass.

The Veterans Administration wants to build a 500-bed hospital in Atlanta, while the Army is closing Oliver General Hospital at Augusta, Ga.

A 500-bed veterans hospital is planned at Ann Arbor, Mich., while the Army is closing the 1,600-bed Jones Hospital at Battle Creek.

No one knows how high the cost of agricultural subsidies will soar. Already the Government has some $4 billion of the taxpayers' money tied up in "surplus" farm commodities, and is now asking for authority to borrow $2 billion more for price support operations. This in spite of the fact that the principal farm leaders have come out in favor of a more flexible support program, that would cost less money. The recent revelations over potato disposal have given the public some inkling of the monumental folly and extravagance of the price support policy as now carried out.

The eagerness of the Administration to pour money into housing seems almost unlimited. Though Congress has, as noted earlier, thrown out the Administration's $2 billion middle-income housing plan, it has voted an additional $750 million to the Federal National Mortgage Association — the government agency for making a secondary mortgage market for F.H.A. and G.I. loans — in order to replenish that agency's $2.5 billion till which had become exhausted. For the past two years the F.N.M.A. has been buying, hand over fist, mortgages that private investors haven't wanted to hold mostly because the rates are too low — especially G.I. mortgages on which a rate of 4 per cent is set by the Veterans Administration. Such purchases are estimated to account for nearly $1 billion of the anticipated

Treasury deficits in each of the fiscal years '50 and '51 — and this at a time when there is plenty of private mortgage money available at rates in line with the market, and when building, both public and private, is at boom levels.

The growing importance in the budget of appropriations for various federal power and water resources projects is often lost sight of because it is divided among six separate agencies. These agencies for fiscal 1951 have requested $1.1 billion which the committee recommends be reduced to $898 million. Appropriations for fiscal 1950 were $890 million. It is significant to note that expenditures of these agencies amounted to $536 million in fiscal 1948 and $823 million in 1949.

With respect to federal water resources projects, the Hoover Commission states that "altogether these authorized and projected construction programs envision an eventual 671 major power, flood control and irrigation projects within the continental United States. It is estimated that this ultimate program . . . will cost in the neighborhood of 40 billion dollars."

Entirely apart from fiscal implications, is the effect of expansion of federal financed electric power with its various subsidies in competition with privately-owned, business-managed, taxpaying electric companies. In 1932, public power accounted for only 6 per cent of total electric generating capacity. By the end of 1949, this had increased to 20 per cent, and the end is not in sight.

Where Are We Heading?

To go on multiplying examples of the thousand and one different leaks, little and big, by which money is draining away from the Federal Treasury would be tedious, and would add little to the weight of evidence already given of the truly enormous scope for economy in our vast swollen budget.

There is no real substance in the old excuse that inability to balance the budget is due to the heavy expense burden of maintaining peace and paying for past wars. Comparison of the 1951 budget with that of 1947, when total expenditures reached the postwar low, shows that combined expenditures for national defense, foreign aid, veterans programs, and interest on the public debt have tended to level out, but that all other government expenditures have risen steadily to a level in the 1951 budget roughly double that of 1947.

One of the hardest things that governments have to do is to control their spending. The line of least resistance is all the other way. Thus, without constant vigilance and restraint, the budget tends to get bigger and bigger, and harder and harder to balance, burdening the nation with taxes, forcing resort to borrowing with its mounting debt and inflation danger, and leading to wider and wider intervention by government in the affairs of the people.

It is evident that this Government is already well along that road. More and more its activities have multiplied, and in more and more ways it has been reaching out and dominating our lives. The staggering cost of all this is reflected in our $40 billion budgets. Despite the fact that taxes already impinge seriously upon incentives, particularly in those groups of the population upon which we are most dependent for business leadership and risk-taking, the Government finds itself unable to make ends meet, even in a period of peak business activity and national income like the present. With growing frequency, people are asking the question: if the Government can't balance the budget under these conditions when can it do so?

The answer to this question would seem to be clear and simple — government spending *must* be cut if the national finances are to be kept sound and the people encouraged to go forward with confidence.

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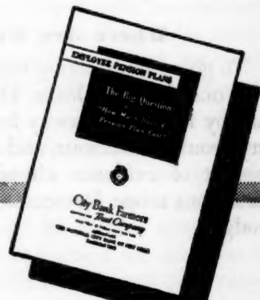

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